Is a 50% Dividend Yield Impossible? Too Risky? Not Really

Description

Even the best dividend stocks pay far less than 10% in annual yield. High-yield stocks that exceed this benchmark usually have something wrong with them, like too much debt or declining earnings.

However, I often think back to an example from Warren Buffett's career, where he managed to generate a seemingly impossible 50% dividend yield. In fact, several of his biggest holdings pay ludicrous dividend yields when you account for his cost basis. Here's a closer look at how Buffett makes his billions and how you can replicate the magic.

Warren Buffett's dividend magic

Buffett's best dividend stock is also his most famous: **Coca Cola**. Buffett invested in the beverage giant in 1988. By 1989, he had purchased 23.35 million shares worth US$1.8 billion. He has never bought or sold any of the company's shares since then.

Today, Buffett holds 400 million shares of Coke at an average cost basis of US$3.25. Meanwhile, the stock pays an annual dividend of US$1.64. That's a cash-on-cash dividend yield of 50.5%. In other words, Buffett doubles his initial investment every two years via dividends alone.

That's not the only one. Several of Buffett's largest holdings pay between 10% to 25% in cash-on-cash dividend yield. This is the result of *dividend growth*, as is the secret to Buffett's long-term success.

Canada's best dividend stocks

To replicate this magic, you need to focus on companies that can pay a high dividend today and *expand dividends over time.* **Fortis** (TSX:FTS)(NYSE:FTS) is a good example.

The utility giant pays a decent dividend yield already: 3.5%. However, this dividend has expanded every year for the past 47 years. Over the last three years, the dividend has expanded at a compounded annual rate of 7%. The company's management aims to expand payouts at an annual rate of 6% until 2024.

At 6% compounded annually, any investment you make today could offer a 50% cash-on-cash dividend yield in 40 years. That's comparable to Buffett's best dividend stock investments.

Of course, other companies could grow even faster. **Alimentation Couche-Tard**, for example, could grow dividends much faster than Fortis. The company currently pays only 9% of earnings in dividends. Meanwhile, the team has been spending billions of dollars to expand overseas in Asia and Australia.

An investment in Couche-Tard stock today could deliver a 50% cash-on-cash dividend yield far sooner than 40 years.

Bottom line

Based on his original cost of investment, Buffett receives a 50.5% dividend yield on his Coke stock. Of course, he had to wait 32 years to achieve this. Buffett's success is a testament to the power of dividend-growth stocks.

A company that can expand dividends over time offers investors a chance to supercharge the power of compounding. By reinvesting the dividends, the shareholder can accumulate *more stock* that pays *more dividends* later. This is the secret to Buffett's long-term success and could be the key to your financial freedom as well.

Companies that can expand earnings over time and generously share the gains with shareholders are the best dividend stocks. Focus on robust Dividend Aristocrats such as Fortis for Buffett-like returns.

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